IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

COMPANY APPLICATION No.266 of 1989

in

COMPANY PETITION No.35 of 1982

For Approval and Signature:

Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

O.L. OF DHAVALGIRI PAPER MILLSPVT.LTD.

Versus

CHINUBHAI KHILACHAND

Appearance:

MR NAVIN K PAHWA for Petitioner No. 1

DELETED for Respondent No. 1

MR RD DAVE for Respondent No. 2-6

SERVED BY RPAD - (N) for Respondent No. 7

NOTICE SERVED for Respondent No. 8

CORAM : MR.JUSTICE D.A.MEHTA

Date of decision: 22/04/2002

ORAL JUDGEMENT

By way of Judge's Summons taken out under Section

543(1) of the Companies Act, 1956 (for short 'the Act'), the Official Liquidator has prayed for an order that :

> "(a) For a declaration that the Respondents Directors of the abovenamed company were guilty of Misfeasance, breach of trust, breach of duty, gross negligence in discharging their duties and managing the affairs of the company.
>
> (b) For a declaration that the Respondents Directors of the above Company, have misapplied retained or became liable or accountable for the money or property of the company.
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> (c) For an order that all necessary inquiries be made and accounts taken for ascertaining what sums the respondents are liable to contribute to the assets of the said company by way of compensation for such Misfeasance and breach of Trust aforesaid.
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> (d) For an order that the Respondents Directors do jointly & severally contribute to the assets of the said company and do pay to the Official Liquidator of the said Applicant Company all such sums as they may be found liable to contribute to such assets together with interest on such sums at the rate of 18% per annum of the said sums here respectively wrongfully paid away until the date of payment.
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> (e) For an order that the said Respondents do pay the costs and incidental to this Application and that of the order made thereunder. "

2. The facts briefly are that the Company (in liquidation) was incorporated on 02-01-1975 and on 17-12-1984 (stated to be 26-11-1985 in the points of claim) in Company Petition No.35 of 1982 an order was made to wind up the Company and the Official Liquidator attached to this Court was appointed as Liquidator of the Company i.e. M/s.Dhavalgiri Paper Mills Private Limited (in liquidation) (for short 'the Company (in liquidation)'). Thereafter, the Official Liquidator has filed the Judge's Summons for initiating misfeasance

proceedings against the ex-directors of the Company (in liquidation) and prayed for the aforesaid reliefs.

On 11-06-1993 the Liquidator was directed by the Court to find out or to indicate the exact instances of misfeasance attracting the provisions of Section 543(1) of the Act. Thereupon the Official Liquidator submitted Report No.115/1993 dated 25-06-1993 wherein permission was sought to get the points of claim prepared by a Chartered Accountant after proper scrutiny of books of accounts and relevant records of the Company. Accordingly, in pursuance of the order of this Court, Chartered Accountants M/s.Jagetia & Company were appointed for carrying out investigation in case of Company (in liquidation). The Chartered Accountants have tendered report dated 22-02-1996 wherein it is stated that books of accounts and financial statements and other relevant records of the Company (in liquidation) pertaining to accounting years 1977-78 to 1984-85 have been examined by them.

3. The facts which are culled out from the report of the Chartered Accountants are that originally the Company was promoted by persons comprising one Patel Group but due to financial crisis, the Patel Group was not in position to run the Company and consequently, one Mr.R.C.Gupta and his Associates took over the management of the Company (in liquidation) w.e.f. 15-05-1979. The new management took various steps to bring the additional funds and increase its sales and consequentially the Company (in liquidation) earned the maiden net profit of Rs.8.55 lacs. However, in the subsequent years the Company (in liquidation) again incurred losses. It is pertinent to note that the Chartered Accountants have opined that the losses were incurred by the Company (in liquidation) :

> "..... due to poor debtors' management, high interest and production costs and lower sales pricing of products of the company ...."

On the basis of the report given by the Chartered Accountants, various points of claim have been prepared and the same are available in paragraph 5(a) to (t). As will be evident hereinafter, for the reasons which follow it will not be necessary to deal with each point of claim individually and, hence, the same are not reproduced.

4. Mr.N.K.Pahwa appearing on behalf of the Official Liquidator extensively read from the points of claim in

support of Judge's Summons and contended that the provisions of Section 543(1) of the Act are applicable to the facts of the case and the ex-directors of the Company (in liquidation) must be compelled to make good monies with interest which they have retained or become liable or accountable for the property of the Company (in liquidation). He invited the attention of the Court to the fact that application under sub-section (1) of Section 543 of the Act had been made within the prescribed period of limitation.

5. As against this, Mr.Rajesh D. Dave appearing on behalf of Respondent Nos.2 to 6 states that Respondent No.2 who was actually in-charge of the various affairs had expired on 27-12-1997. That Respondent No.5 had filed an affidavit-in-reply on behalf of Respondent Nos.3 to 6 on the basis of available records after carrying out inspection of such records lying with the Official Liquidator. It is further stated that the business of the Company (in liquidation) was being looked after by Respondent No.2, namely, deceased Shri Rameshchandra Kishanlal Gupta and the accounts were being audited by M/s.N.M.Shah, Chartered Accountants of Surat who has also expired. In these circumstances, it was not possible for the deponent to answer with precision individual detailed points raised in points of claim due to passage of 20 years coupled with the fact that Respondent Nos.3 to 6 were not in charge of day-to-day affairs of the Company (in liquidation). It is further stated that there may be different opinions as regards entries and the method of accounting employed but that would not lead to the charges of misfeasance against the ex-directors. It is further submitted that Respondent No.7 Shri Patel Bhagwatprasad Ravjibhai was 70-years-old in 1983 and he was on the Board of Directors by virtute of nomination by Gujarat State Financial Corporation. That the information available with the deponent is that the said Shri Patel Bhagwatprasad Ravjibhai has also expired. Similarly, Respondent No.8, namely, Ramanlal Kishrichand Shah was also more than 75-years of age in 1983 and the deponent is not in position to contact these persons and obtain any further information in the matter. After reading extensively from the two affidavits-in-reply filed on behalf of Respondent Nos.3 to 6 Mr.Dave submitted that the points of claim being totally vague, general and the applicant having failed to make out any case against the individual directors the application should be rejected with costs.

6. Provisions of Section 543(1) of the Act have come up for enunciation before the Apex Court in number of

matters.

In OFFICIAL LIQUIDATOR V RAGHAVA DESIKACHAR AIR 1974 SC 2069 the Supreme Court has observed as under :-

> "... It may be mentioned that misfeasance action against the Directors is a serious charge. It is a charge of misconduct or misappropriation or breach of trust. For this reason the application should contain a detailed narration of the specific acts of commission and omission on the part of each Director quantifying the loss to the Company arising out of such acts or omissions. The burden of proving misfeasance or nonfeasance rests on the Official Liquidator. The Official Liquidator, it may be mentioned, merely relied upon the evidence recorded in public examination of the Directors and on a few documents tendered in evidence. At the stage of public examination there was no charge of misfeasance against the Directors and they were not in a position to know what would be the grounds that would be alleged against them for recovering any amounts, for the loss said to have been caused to the Company by reason of such misfeasance."
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> (emphasis supplied)

In OFFICIAL LIQUIDATOR, SUPREME BANK LIMITED V. P.A.TENDOLKAR 43 Comp. Cases 382 = AIR 1973 SC 1104 the Court laid down the following principles in para 40 of the judgment :-

> "40. It is certainly a question of fact, to be determined upon the evidence in each case, whether a Director, alleged to be liable for misfeasance, had acted reasonably as well as honestly and with due diligence, so that he could not be held liable for conniving at fraud and misappropriation which takes place. A Director may be shown to be so placed and to have been so closely and so long associated personally with the management of the Company that he will be deemed to be not merely cognizant of but liable for

> fraud in the conduct of the business of a Company even though no specific act of dishonesty is proved against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the Company even superficially. If he does so he could be held liable for dereliction of duties undertaken by him and compelled to make good the losses incurred by the Company due to his neglect even if he is not shown to be guilty of participating in the commission of fraud. It is enough if his negligence is of such a character as to enable frauds to be committed and losses thereby incurred by the Company."

7. Therefore, to bring the charge of misfeasance against the ex-directors it is necessary that specific acts of commission or omission and/or negligence on the part of each director are pointed out; the loss arising to the Company as a result of such specific act of commission or omission or negligence shall also have to be quantified as the order of recovery from such a director would be based on the said quantification. The liability under the provision though in the nature of tortious liability, it yet is quasi-criminal in nature and it is a particular director who has caused loss to the Company by his act which would amount to misappropriation, breach of trust, misapplication or retention of monies / properties of the Company who would be called upon to make good such loss. Thus, the onus is on the person who alleges such acts of misfeasance. The onus has to be discharged by cogent, reliable and specific evidence which should prove that the alleged misconduct was willful and amounted to misfeasance with culpable negligence. The meaning of misfeasance is the improper performance of same act which a person may lawfully do. Thus seen, a director while carrying out an activity which he is otherwise empowered to carry out under the law, performs it in such a manner that the same is improper and such impropriety has to be willful so as to cause loss to the Company. In other words, the act of commission or omission or negligence should be with the intent and knowledge to cause loss to the Company and at the same time resulting in personal gain. Not all acts which result in loss to the Company can be treated as acts of misfeasance, making a director liable under Section 543 of the Act, because while carrying on business there is every likelihood that loss may be incurred in a transaction or number of transactions. It

is only when such loss to the Company results in wrongful gain to the director in question that it would fall within the scope of provisions of Section 543 of the Act.

8. Applying the aforesaid test, is it possible to state in the present case that all the respondents singly or jointly had committed any specific acts of commission or omission or had misapplied or retained any monies / properties of the Company (in liquidation) ? The Chartered Accountants in their report have specifically stated that the losses had been incurred by the Company (in liquidation) due to poor debtors' management, payment of higher interest, higher production costs and lower sales pricing of the products of the Company. At the highest, this could be termed as acts of poor financial management. The observations hereinbefore culled out from the Chartered Accountants report are based on the following findings, if one may term them to be findings :

> "It creates doubts about reasonability of sales pricing. The pattern of sales pricing in detail is enclosed in Annexure-C herewith.
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> . . . . .However, we have doubt that for some of the sales returns neither fresh bills have been prepared nor it was considered in stock. The details of the same is enclosed in Annexure-D herewith.
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> . . . . .Thus, we are of the opinion that some of the Burnt Coal / Dust sales might not have been accounted for. The comparison chart for coal consumption and sale of Burnt coal Dust is enclosed herewith in Annexure-E.
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> 4. Conclusion :
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> In the light of our observations mentioned hereinabove we are of the opinion that the affairs of the Company were not managed properly and there is possibility of some misfeasance or breach of trust by the Ex-Directors and/or Ex-Officers of the Company to the extent as reported hereinabove.
> (emphasis supplied)

9. Therefore, as can be seen from the conclusion in the report of the Chartered Accountants, there is no

single act which can be said to have been committed by a particular director within the meaning of the provisions of Section 543(1) of the Act. In fact, the Chartered Accountants merely say that the affairs of the Company were not managed properly and there was possibility of some misfeasance or breach of trust by the ex-directors and/or ex-officers of the Company. In light of this conclusion, it is not possible to accept the say of the Official Liquidator that the Respondents Directors were guilty of misfeasance, breach of trust, breach of duty or gross negligence in discharging their duties and managing the affairs of the Company. Even going by the report of the Chartered Accountants, the possibility of misfeasance or breach of trust is in relation to the ex-directors and/or ex-officers of the Company. In such circumstances, it is not possible to state that provisions of Section 543(1) of the Act are applicable and no relief under the said section can be granted in absence of any cogent material having been brought on record by the applicant. The applicant has failed to discharge the onus.

The Company application is accordingly rejected. There shall be no order as to costs. Notice discharged.

Sd/-
(D.A.Mehta, J)
'Bhavesh'